VIEWPOINT

Coface's analysis about crisis development

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"Bent L curve" recovery

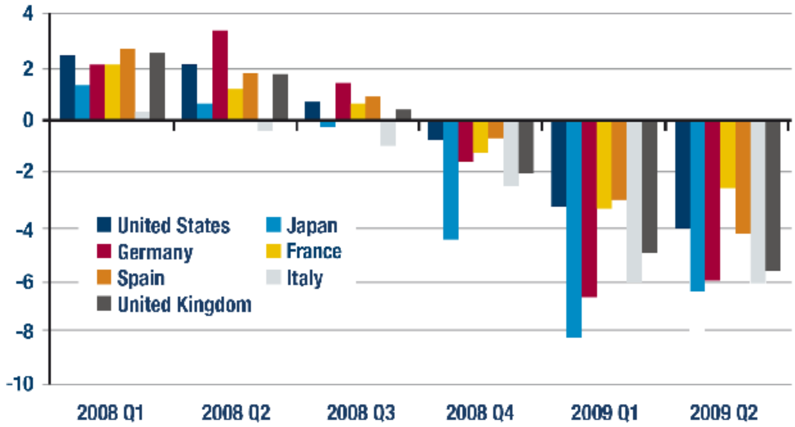
2009 and 2010 scenarios

The first half of 2009 has confirmed the trend observed at the end of 2008: the United States, the euro zone and Japan have seen its production shrink. Therefore, the recession is of an unprecedented scope since the Second World War in the industrialised countries. Furthermore, it is synchronised, which is leading to record contraction in world trade (-11% for all of 2009 according to the latest IMF forecasts). It is more pronounced in countries that are major exporters of capital goods (Germany and Japan).

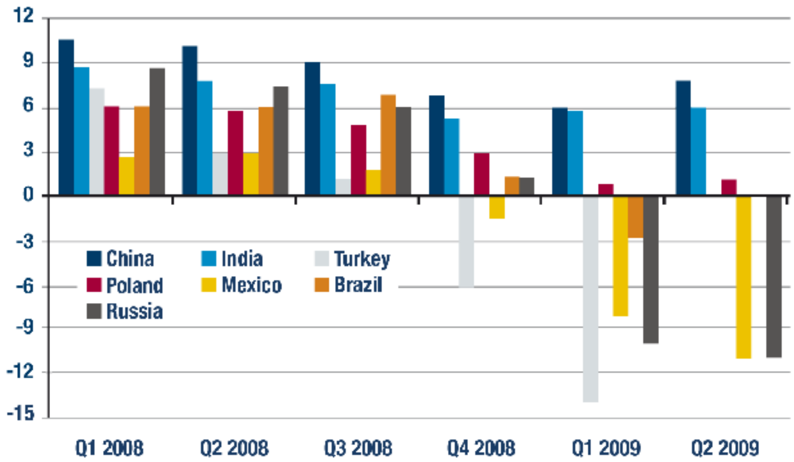
In emerging countries, the situation is more contrasted. Indeed, we are seeing brutal recessions in the emerging countries in Europe and in the CIS; the situation is rather contained in Latin America and there are only modest slowdowns in China and in India.

These changes have led us to establish a new growth forecast for 2009: the worldwide recession is now evaluated at -2.1%, with growth in industrialised countries at -3.6% and +1.1% for the emerging countries.

Real GDP (% change - year on year)



Real GDP (% change - year on year)



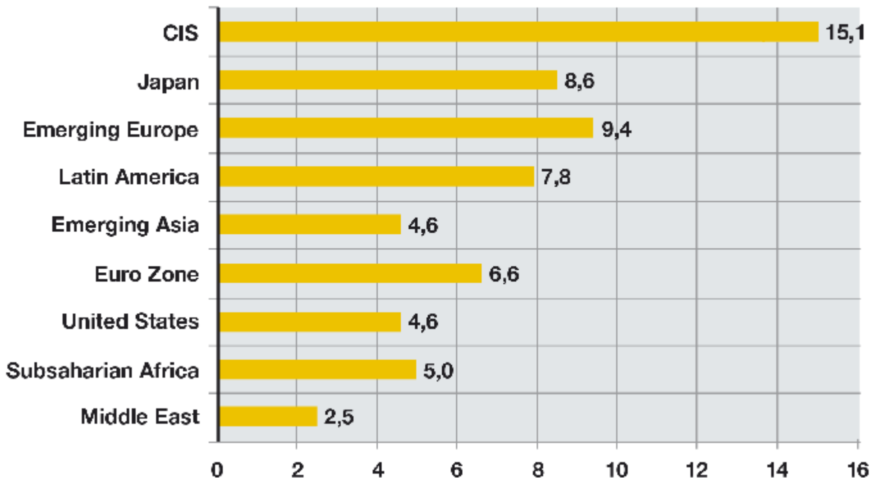
In the euro zone, the downward adjustment is consistent with the expected recession of 4%. The recession in Germany is adjusted to -4.8% due to the export crunch.
The export crunch observed at the end of 2008 is amplifying the growth shock in Germany as in Japan where the economic situations were highly dependent on the dynamics of world trade. But, everywhere in Europe, exports and company investment are dragging production down, and the expected drops in these two components of demand are -14% and -10% respectively in the euro zone. Household consumption seems to be resisting: in the second quarter of 2009, it made a positive contribution to activity in the euro zone.
Substantially affected by a real estate crisis combined with major private indebtedness, the drops in GDP will exceed 3% in the United Kingdom and in Spain.

With regards to emerging countries in Europe, the recession is now expected to be -3.7% for 2009. The impact of the sudden stop is substantial here in one of the rare emerging regions that depends on international cash flows. Moreover, the European recession (with which East Europe trades mostly) and private overindebtedness (often in foreign currency) are bearing down on activity. The CIS is also highly impacted at -6.6% (with contraction at -7.5% for Russia).

Latin America is resisting fairly well but the situation is contrasted, as Central America is clearly much more impacted than South America: the continent should show growth of -2.4%, with recessions expected in the continent's two major economies, in Brazil (-0.4%) and in Mexico (-7%). The situation is more favorable in Asia: only two countries have had their forecasts moved upwards, China which is now at 8.5% and India at 5.5%. For the first, the economic recovery policy was extremely effective, to the point of raising debates concerning the poor allocation of capital. At the beginning of the year, bank credit experienced growth rate of 30%, however, this primarily benefits public companies. In India, the economy is relatively closed and in addition, the result of the general elections in May – with the clear victory of the Indian National Congress – opens the road to a period of more dynamic reform, which is boosting the confidence of economic actors.

If we take the extent of the slack into consideration, these adjustments result in considering the CIS, the emerging countries in Europe, Japan and Latin America as the geographical areas recording the highest losses in growth between 2007 and 2009:

Losses in growth between 2007 and 2009 (% points)



2010 and the profile of the recovery

For 2010, our growth forecast changes very little compared to the previous period. The scenario is still that of a very low recovery in the industrialised countries due to the degree of private indebtedness, which is especially restrictive in the United States, in the United Kingdom and in Spain. A recovery could be more straightforward in the emerging countries that are not "overindebted".

In Asia or Latin America, simmering world trade and a stabilization of raw materials prices will have quick positive effects on activity. World GDP – at market rates – should increase +2.3% with + 1% for industrialised countries and +4.9% for emerging countries. In Spain as well as in Ireland, Belgium and Portugal, negative growth is still expected in 2010.

The extent of the crisis will also continue to have a negative impact on activity in the Baltics (where double-digit drops in GDP are expected in 2009) and in Hungary.
According to our main scenario, we expect the recession to end in the third quarter of 2009. Global production should stop falling. It is however expected that the rate of growth in activity be very low until the end of 2010.

A "bent L curve" scenario remains the most likely.

The possibility of the recession ending in the third quarter is based on a certain number of indicators that are currently pointing in the right direction: In the United States, the real estate market is generating a few positive signs. Individual home sales bounced back in July. As for prices, over one year, the drop has clearly slowed down. With regards to activity, a slight recovery is taking place in Germany and in France with a slightly positive growth rate on a quarterly basis in the second quarter of 2009.

Above all, it is the expectations of the economic players that have been better oriented for a few months now. The confidence indicators for business and households have been turning around since the beginning of the second quarter. In the United States, the returning of investor confidence accelerated in August. In Germany, we are seeing one of the sharpest rises in the industrial confidence index since the 1980s.

Disinflation is also a strong driver for demand, the inflation rates should be from -0.1% in 2009 and 1.8% in 2010 in the United States and between 0.5% and 1.3% in the euro zone. The recoveries in China and in India are also boosting confidence.

Other indicators are showing that optimism is on the way back but these need to be interpreted with caution as they are in part the result of the euphoria in financial investors who are "betting" on a return to growth and are reinvesting dormant liquidities in riskier assets. The stock markets in the industrialised countries have had remarkable index rises since the low point at the beginning of March 2009: since the beginning of the year, the stock markets in New York, London and Paris increased 8, 10.7 and 13.5%.Prices for raw materials are moving upwards: the CBRT index (composite for all raw materials) dropped sharply by 54% between June 2008 and February 2009. Since this date and until the end of May, the index has recorded an increase of 20%.

The renewed appetite for risk is also resulting in the rising stock market indices and exchange rates of the emerging countries since February 2009. This comeback seems highly tributary to the news that will or will not confirm the positive changes going on in the current economy. Any bad news could indeed lead to a new crisis in terms of confidence. As such, these movements must not be interpreted as tangible elements confirming that the recession is stopping.

So the risk is that the constitution of new bubbles on the financial markets or in terms of commodities accelerate activity artificially. Indeed, investors may be overly optimistic while final demand (American consumers) is having trouble recovering.

In this timid recovery scenario, we believe that the credit crisis instead of credit crisis – which is viewed as an increase in the amount of companies' claims – will absorb itself over the course of the second half of 2009. Indeed, companies who survived the sharp drop in demand that occurred at the end of 2008-beginning of 2009, will be even further able to absorb lifeless or slightly positive demand.

Unjustified increases… are the bubbles threatening again?

	Current situation	Outlook
Credit bubbles		
- Industrialised countries	has burst	absorbing itself?
- Emerging countries	has burst	absorbing itself
Real estate bubbles	has burst	absorbing itself
Market bubbles	reforming	high volatility
Over-capacities in China	reforming	amplification
Exchange rate risk		
- United States	reforming	moderate amplification
- Emerging countries	reforming	amplification
Commodities bubble	reforming	amplification

...A W scenario cannot be excluded.

In the second part of 2009, growth could benefit from a stock reconstitution effect after the destocking period that characterised Q4 2008 and Q1 2009. In Q3 2009, we should feel the impact of the increase in public expenditure or tax incentives. But these effects can run out if domestic demand is still hindered by defeasance.

Household consumption (75% of the American GDP, 65% of the British GDP, 58% of Spanish FSP) is being attacked on two fronts: household overindebtedness is prohibiting new expenditures and a continuing rise in the rate of saving is therefore inescapable in these three countries; unemployment is expected to rise quickly in the industrialised countries (in the United States, the unemployment rate is expected to change from 5.8% to nearly 9.9 in 2009, and in the euro zone from 7.6% in 2008 to 9.7%).

With regards to American household savings, an examination of its long cycle shows that private savings has stabilised at about 8% of disposable income between 1985 and 1992 before starting to drop progressively until 2007 when the rate became zero. Since then, the rise in the savings rate has been very quick and stands at 4.4% at the beginning of 2009 and at 6.9% in May.

Certain factors, such as the improvement in access to credit or to decline in disposable income, could drive this rate down. Others, such as continued unfavourable developments in the labour market, could encourage households to continue to save to the detriment of their consumption which represents no less than 18% of world GDP.

One of the main elements for getting out of the crisis will therefore be an upswing in the American labour market.. The risk is that the second half of 2009 be a jobless recovery, which would contribute in preventing private demand from sustaining activity in 2010.

On a more fundamental basis, if the American economy follows the dynamics of a structural change in consumer behaviour, this can mean that we would go back to a savings rate of about 8%. In this hypothesis, there should still be one year of quasi-stable or declining expenditure in American households, which means that the end of the recession is pushed to 2010.

The recovery in industrial production that we have seen in a few industrialised countries in the summer of 2009 could be linked to overly-favourable expectations. The risk is that this upswing becomes a flash in the pan because in light of this upswing in supply, final demand may not be around. We would then see a drop in activity which would once again result in companies with claims.

As such, Coface is taking a cautionary stance as to interpreting signs of recovery. We feel that if growth is positive in 2010, it will remain very short-winded as the times of splendour for the American consumer are in the past.

By Yves Zlotowski
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Summary of scores of the main economies

INDUSTRIALISED COUNTRIES

Country	Score	Since...
Australia	A2	March 2009
Canada	A2	March 2009
Japan	A2	March 2009
Germany	A2	March 2009
France	A2	March 2009
United States	A2↘	March 2009
Italy	A3	March 2009
United Kingdom	A3	March 2009
Spain	A3↘	March 2009

EMERGING COUNTRIES

Country	Score	Since...
Korea	A2↘	March 2009
India	A3	December 2004
South Africa	A3↘	June 2008
China	A3↘	December 2008
Poland	A3↘	March 2009
Saudi Arabia	A4	December 2001
Brazil	A4	December 2006
Mexico	A4↘	Mars 2009
Indonesia	B	March 2004
Turkey	B↘	March 2009
Russia	C	March 2009